TAX MANAGEMENT ASSOCIATION OF THE PHILIPPINES, INC.

TMAP TAX UPDATES FOR MAY 2014

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BIR ISSUANCES

Revenue Memorandum Circular No.34-2014 clarified the rule on whether or not an assessment resulting from jeopardy/arbitrary assessment or which was based on “best evidence obtainable” method could be considered as a “doubtful assessment” contemplated in Section 3 of Revenue Regulations No. 30-2002 in so far as compromise settlement application is concerned. An assessment based on “Best Evidence Obtainable Rule” should not be automatically considered as a doubtful assessment. Scrutiny as to the surrounding circumstances that led to the issuance of such an assessment should be thoroughly evaluated.

Revenue Memorandum Circular No.36-2014 clarified the price ceiling of socialized lot only pursuant to Revenue Regulations (RR) No.11-97, RR No.17-01 and Housing and Urban Development Coordination Council (HUDCC) Resolution No. 1, Series of 2013.The ₱450,000.00 price ceiling for socialized housing applies to house and lot package. If only a lot is sold, the price ceiling should only be ₱180,000.00 per lot.

Revenue Memorandum Circular No.39-2014 clarified the tax treatment of payouts by employee pension plans. As a general rule,Section 60(A) of the National Internal Revenue Code (NIRC) of 1997,as amended, subjects the income of any kind of property held in trust to Income Tax. As an exception, Section 60(B) exempts from Income Tax an employee’s trust which forms part of a pension, stock bonus or profit-sharing plan of an employer for the benefit of some or all of his employees subject to the following conditions:

a. Contributions are made to the trust by such employer, or employees, or both for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan; and

b. Under the trust instrument, it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees under the trust, for any part of the corpus or income to be(within the taxable year or thereafter) used for, or diverted to,

purposes other than for the exclusive benefit of his employees.

As an exception to the said exception, Section 60(B) subjects to Income Tax, in the year in which so distributed, any amount actually distributed to any employee or distributed to the extent that it exceeds the amount contributed by such employee or distributee. The entire amounts of benefits paid by a pension, stock bonus or profit-sharing plan of an employer for the benefit of employees are taxable on the part of the employees in the year so distributed. This tax treatment, however, does not apply to payouts representing a return of an employee's personal contributions to the fund and to retirement benefits exempt under Section 32(B)(6)(a) of the NIRC.

Revenue Memorandum Circular No.40-2014 prescribes the use of Electronic Certificate Authorizing Registration (eCAR)(BIRForm No.2313-R for Transaction Involving Transfer of Real Properties and BIR Form No.2313-P for Transaction Involving Transfer of Personal Properties).The manual issuance of Certificate Authorizing Registration(CAR)shall be discontinued upon the rollout of the eCAR System in the Revenue District Offices (RDOs)/Large Taxpayers (LT) Audit Divisions. Under the *e*CAR System, one (1) *e*CAR covering one real property shall be issued. Thus, there will be as many *e*CARs as there are real properties to be transferred. However, for transactions involving transfers of personal properties, one (1) *e*CAR may be issued covering the transfer of more than one (1) personal property.

Revenue Memorandum CircularNo.46-2014 clarified the taxability of financial lease for purposes of Documentary Stamp Tax (DST). Based on the foregoing definition of a Financial Lease under Revenue Regulations No. 9-2004, the same is akin to a debt rather than a lease. Financial Lease is not only akin to an obligation by definition but also by treatment. Also, the International Accounting Standard (IAS) on Leases (IAS17) requires that a liability be set up in the lessee's books of accounts. Although documents, transactions or arrangement under financial lease are not specifically mentioned under Section179 of the National Internal Revenue Code (NIRC), as amended, the imposition of the DST under such Section of the NIRC, as amended covers all debt instruments. Therefore, being a nature of an obligation, financial lease is covered under such Section of the NIRC, as amended. Accordingly, any document, transaction or arrangement entered into under financial lease is subject to the DST under Section 179 of the NIRC, as amended.

Revenue Memorandum Circular No. 37-2014 regarding the applicability of the Philippines-Kuwait Double Taxation Agreement entitled *"Agreement between the Government of the Philippines and the Government of the State of Kuwait for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*" which was entered into force on April 22, 2013.

The provisions on taxes on income of the Agreement shall apply to income derived or accrued beginning January 1, 2014. Despite the Deutsche Case where the Supreme Court ruled for the automatic application of tax treaties, the BIR imposes a prerequisite before the Philippine-Kuwait Tax Treaty may take effect. According to the BIR, Tax Treaty Relief Applications (TTRAs) invoking the Philippine-Kuwait Agreement should first be filed and addressed to the International Tax Affairs Division (ITAD) of the BIR, together with duly accomplished BIR Form 0901 (Application for Relief from Double Taxation) and other documentary requirements pursuant to Revenue Memorandum Order (RMO) No. 72-2013 before the tax treaty relief may be enjoyed.

BIR Ruling No. ITAD 049-14, May 2, 2014 – On a query regarding the VAT implication of a purchase of motor vehicle by an officer of the World Health Organization (WHO) from an officer of the Asian Development Bank, the BIR ruled that while WHO, as an organization is exempt from VAT, such exemption applies only to purchases under the name of WHO for its official use. Thus, sale by a privileged seller to the buyer, being a non-privileged buyer, is subject to VAT pursuant to Section 106 of the NIRC. Accordingly, since VAT is an indirect tax, this tax may be shifted or passed-on to the buyer of the subject motor vehicle from a privileged seller.

COURT OF TAX APPEALS DECISIONS

Commissioner of Internal Revenue vs. First Gas Power Corporation, CTA EB No. 972, May 12, 2014

An assessment cannot be considered valid if it does not indicate a specific period or date within which the alleged tax liabilities shall be paid. The date within which the taxes shall be paid is material in an assessment notice. Otherwise, it will be at the liberality of the taxpayer when the taxes will be paid. If no specific period is indicated in the Final Assessment Notice and Formal Letter of Demand then it would no longer be a demand to pay. The importance of setting a deadline within which the taxpayer must pay cannot be stressed enough. Without it, the prescriptive period set forth in the Tax Code would not be determined with any certainty, rendering it nugatory. It cannot be considered a demand to pay but merely a request to pay.

BPI-Philam Life Assurance Corporation vs. Commissioner of Internal Revenue, CTA Case No. 8240, May 14, 2014

An assessment that is issued for the first time in an FDDA prescribes if the FDDA is issued after the lapse of the 3-year prescriptive period for the issuance of an assessment.In this case, the taxpayer received from the BIR a Formal Letter of Demand on January 7, 2010 assessing it for deficiency income tax and deficiency VAT for the taxable year 2006. Included in the deficiency assessment is the VAT on interest income from loans and receivables. Taxpayer filed a protest, arguing, among others, that it is not liable for VAT on interest income on policy loans. On February 24, 2011, taxpayer received a Final Decision on Disputed Assessment (FDDA), removing the VAT assessment on interest income from loans and receivables. However, the FDDA imposed a 5% premium tax on the interest income on policy loans.

In its petition for review filed before the CTA, taxpayer argued among others that the BIR's right to assess had already prescribed. It also argued that the constitutional guarantee of a taxpayer's right to due process was not observed when the BIR arbitrarily changed the nature of the deficiency assessment on interest income on policy loans from deficiency VAT to deficiency premium tax. The CTA agreed with the taxpayer. The deficiency premium tax was made known to taxpayer for the first time when the BIR issued the FDDA. Hence, the BIR's right to issue an assessment has long prescribed when the BIR issued the FDDA on February 24, 2011 cancelling the original VAT assessment on interest income on policy loans and in its stead imposed deficiency premium tax for the first time without prior notice and opportunity to protest the same.

East Asia Utilities Corporation vs. Commissioner of Internal Revenue, CTA Case No. 8179, May 21, 2014

Taxpayer is registered with the Philippine Economic Zone Authority (PEZA) as an ECOZONE utilities enterprise entitled to the 5% preferential tax rate on gross income. Taxpayer was issued a deficiency income tax assessment, arising mainly from the disallowance of some items of cost of sales/services claimed by taxpayer. Taxpayer argued that the enumeration of direct costs under RR No. 11-05 is not an exclusive or closed list of expenses that may be deducted by a PEZA-registered enterprise from its gross sales for the purpose of computing the 5% gross income tax. Instead, the enumeration of direct costs is intended as a guide in determining the items that may be considered direct costs or costs of sales. The CTA agreed with the taxpayer. According to the CTA, it is clear from the amendment made under RR No. 11-05 that the list is not meant to be all-inclusive but merely enumerates the expenses that can be considered

as direct costs. PEZA-registered enterprises may be allowed to deduct costs even though the same are not included in the list. The Court further noted that the criteria in determining whether the item of cost or expense should be part of the direct cost is the direct relation of the item in the rendition of the PEZA-registered services. If the item of cost or expense can be directly attributed in providing the PEZA-registered services, then it should be treated as direct cost.

Commissioner of Internal Revenue vs. Liquigaz Philippines Corporation, CTA EB No. 989, May 22, 2014

The requirement that "the taxpayer shall be informed in writing of the law and the facts on which the assessment is made; otherwise the assessment shall be void" applies to FDDA. Based on Section 3.1.6 of Revenue Regulations No. 12-99, it is clearly necessary for the BIR to inform the taxpayer of the facts, law, rules and regulations and jurisprudence on which the decision is based, otherwise, the decision shall be void. In this case, while the FDDA indicated the legal provisions relied upon for the assessment, the basis or the sources of the amounts from which the assessments arose were not shown. The need for stating the factual basis, i.e., for specifying the source of the amounts used in the assessment, gains more prominence in the instant case, where the FDDA reflects different amounts than that contained in the Formal Assessment Notice. Without the statement of the factual basis, or details of the assessment, the FDDA suffers from the appearance of being a mere arbitrary reduction of the assessment previously reflected in the Formal Letter to Demand. Thus, the assessment is void.

Solid-One Mills, Phils., Inc. vs. Commissioner of Internal Revenue, CTA Case No. 8507, May 29, 2014

The BIR has a period of five years within which to collect the tax assessed, reckoned from the date the assessment notice has been released, mailed or sent by the BIR to the taxpayer.The taxpayer received both the FLD and the FAN on June 8, 2007. As it was not established when the FLD and FAN were released, mailed or sent by the BIR to the taxpayer, the date of receipt by the taxpayer should be regarded as the date when the FLD and the FAN were released, mailed or sent to the taxpayer. Since the taxpayer received the FLD and the FAN on June 8, 2007, the BIR had until June 8, 2012 within which to collect the deficiency taxes.

Although the Notice of Tax Lien, Warrant of Distraint and/or Levy and Warrants of Garnishment were issued by the BIR on June 7, 2012, or one day before the expiration of the period for collection on June 8, 2012, the Notice of Tax Lien was served on the

Register of Deeds on June 14, 2012 and the Warrants of Garnishment were received by the banks on June 15, 2012 and June 18, 2012. Distraint and levy proceedings did not validly begin or commence with the mere issuance of the Warrant of Distraint and/or Levy. The Warrant of Distraint and/or Levy must be served upon the taxpayer within the prescriptive period to collect, in order to suspend the running of the prescriptive period for collection of deficiency taxes. Since the Warrant of Distraint and/or Levy was served on taxpayer only on June 14, 2012 or six days beyond the expiration of the five-year period, the government lost its right to collect the assessed deficiency taxes and penalties.